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BUSINESS AND BUREAUCRACY: A LIMITED CRITIQUE OF CHARLES LINDBERG--ETC(U)

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BUSINESS AND BUREAUCRACY: A LIMITED CRITIQUE
OF CHARLES LINDBLOM'S POLITICS AND MARKETS

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The Rand Corporation
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BUSINESS AND BUREAUCRACY: A LIMITED CRITIQUE
OF CHARLES LINDBLOM'S *POLITICS AND MARKETS**

Thomas L. McNaugher

In a book that deals with grand issues concerning the relationship of business and the political system, Charles Lindblom finally turns in the concluding chapter of his *Politics and Markets* to some specific recommendations. To alleviate business privilege and the ubiquitous "business veto," both of which impede, in Lindblom's view, the nation's ability to deal with its problems, Dr. Lindblom suggests that we take a lesson from the nation's defense sector. Defense industries, he asserts, seem willing enough to accept a high degree of government control in return for assured profits. The lesson is clear: the government can limit corporate autonomy by guaranteeing profits, even in the case of "enterprises producing for ordinary markets rather than for government contracts" (p. 349). Financial indulgence, to use Dr. Lindblom's expression (p. 351), can be used to "offset regulatory severity."

The idea needs more clarity than Lindblom gives it. Many businessmen would argue, for example, that the federal government already imposes regulatory severity through a host of agencies like the EPA, FDA and OSHA. Although the government does not directly reimburse businesses to cover the costs of complying with these regulations, consumers do--by paying higher prices in the marketplace. We thus have a right to ask how the system Lindblom has in mind would differ from what we now have. And to that question *Politics and Markets* supplies no ready answer.

*This essay is one of a series of critiques of Lindblom's book written for Georgetown University's Ethics and Public Policy Center. Lindblom's work emphasizes, among other things, what the author sees as the overwhelming reactionary power of the business elite in Western industrial democracies. This critique examines his reference to the government's control of businesses in the defense sector as a model worth applying in other sectors of the economy in an effort to eliminate the "business veto" to innovative social policy.

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We may assume, however, that Lindblom sees his system as different in both degree and kind from current practice. He clearly doubts the effectiveness of existing regulatory agencies; businesses often control these agencies, and as often as not ignore those few regulations that find their way into federal statute books. He would prefer that the government speak to business in the language businessmen best understand: money. By adopting the variety of means the Defense Department employs to insure profits for its contractors, the government can effectively "buy out" business opposition to a major increase in meaningful regulations.

But Lindblom has more than financial incentives in mind. If he discusses "financial inducement to business," he also mentions "government control over them" (p. 349). I assume that in this he refers to the notion of "hybrid popular control" developed in an earlier section of his book. Such a system would combine "market control over outputs with polyarchal control. . . ." (p. 156). The government then could

turn corporate decisionmaking in any direction [it] desires--toward growth, toward energy conservation, toward environmental protection, or any other national objective--rather than leave corporate decisions within a range to be determined by the accidents of corporate policy or the private proclivities of corporate leadership. (p. 157)

On the assumption that this quick review properly characterizes Dr. Lindblom's system, I would like in what follows to test that system against the realities of this nation's postwar experience with a large defense sector. After arguing in the next section that the system could in fact be realized, I turn in subsequent sections to the questions of how much it would cost and whether or not it could be susceptible to control. In the concluding section I turn the fruits of this analysis back on some of the larger themes of *Politics and Markets*.

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Is Lindblom right? Does he take the correct lesson from the nation's defense sector? Do defense firms really accept a high degree of government control in return for assured profits? Although Lindblom is stretching the point a bit, I think he generally is on the mark.

The government agencies that oversee defense contractors indeed perform the functions Lindblom has in mind. In particular, they oversee contractor activities, sometimes in the extreme. Because as federal agencies the military services must respect federal regulatory statutes, they watch closely to see that defense firms comply with these regulations, as well as with a great many more than the Defense Department and each service may impose. And because the services must justify costs to the Congress each year, they usually keep close track of expenses within each firm. Both of these functions require the creation of a rather large staff of military and civilian employees within each military service whose task it is to keep tabs on the costs and business decisions of defense firms. From the project offices that oversee specific firms working on specific projects back to the overarching research and development organizations within each service, these staffs constitute a veritable "parallel hierarchy" to the managerial staffs of defense firms themselves.

In fact, these federal bureaucracies perform even more functions than those which would be associated with Lindblom's scheme. The defense sector, after all, is a "planner sovereignty" system, one in which the government buys outputs. Thus a great deal of what passes between the military services and contractors working for them consists of descriptions of what the military wants--so called "military requirements." These descriptions can be incredibly long and detailed. They also may change quite frequently over the life of a project--a fact that helps create the cost overruns that plague the industry. Aside from their stable of business and cost analysts, then, military project offices maintain large and sometimes highly skilled engineering staffs to ensure that industry does its best to meet every need. The interaction between these staffs and industry's own designers and engineers can produce a good deal of sound and fury. But this signifies nothing for Lindblom's "consumer sovereignty" system.

Clearly the government's "parallel hierarchy" has the potential to control defense firms, and the Armed Services Procurement Regulations in fact allow them to do so. To be sure, the services do not always choose to exercise the controls available to them. Projects in which firms compete to produce a single item, for example, generally demand less oversight and control than projects involving a single firm. And, at least since 1971, announced Defense Department policy has been to minimize oversight and control in an effort to encourage creativity and efficiency in defense industries.¹ Still, the fact remains that Defense Department contracting agencies have the potential to control business, and often do so.

In the broadest sense, firms accept such oversight and control because they are paid to accept it; it is certainly true that none accepts it *willingly*. But this point should be tempered by a sensitivity to certain structural factors in the market that more or less compel most important defense firms to accept Pentagon control. Many of these firms have no choice--they simply lack alternative markets. Although Lindblom cites Seymour Melman to support his argument that defense firms are in fact controlled, he fails to cite Melman's own argument as to why they submit to it:

The formally private military-industry firms operate on behalf of a monopoly customer, with no alternative customer in sight. This marketing dependency reinforces the direct managerial control system.²

¹I refer here to the so-called "Packard reform," initiated by then Deputy Secretary of Defense David Packard and found in Department of Defense Directive 5000.1, "Acquisition of Major Defense Systems," 13 July 1971.

²Seymour Melman, *Pentagon Capitalism* (New York: McGraw Hill, 1970) p. 77. For Lindblom's use of this source to substantiate his claim that the Defense Department exercises tight control over business, see *Politics and Markets*, p. 111. James Kurth makes much the same points in his "Aerospace Production Lines and American Defense Spending," in Richard G. Head and Ervin J. Rokke, eds., *American Defense Policy* (Baltimore: Johns Hopkins University Press, 1973) pp. 626-640. Finally, the notion of a symbiotic relationship between the Defense Department and its major contractors has been a persistent theme in the works of John Kenneth Galbraith. See for example his *Economics and the Public Purpose* (New York: New American Library, 1973) especially page 139.

The fact is that over years of meeting the Defense Department's demands for extremely sophisticated technology (with what often are necessarily inefficient production techniques by mass-production standards), some firms can do little else. Other firms--those producing rifles or helicopters, for example--have the option of producing for civilian markets, but can rarely find in this sector orders as large as those placed by the military services. To the extent that these firms are all relatively assured of profits, they accept a high degree of control.

Whether or not the military services choose to control the firms doing business for them, they have the authority, the information and expertise to do so. And whether or not these firms enjoy being scrutinized and controlled in this way, they seem willing to put up with it for--among other things--the assured profits they receive in the bargain. Thus in principal, at least, such a system could be duplicated "in the case of firms producing for ordinary markets." Still, the nation's defense experience may have serious implications for Lindblom's suggestions about greater government control of business through economic incentives. Gaining a high degree of control over other industries may be dependent on the institution of government purchases of final products or what Lindblom calls "planner sovereignty" markets so that firms will have the same assured profits but be dependent on a single clientele.

* *

Even if control can be gained without government purchase of consumer markets, I doubt that the degree of control Lindblom has in mind can be imposed very cheaply. In the first place, his system would entail the construction of a sizable federal bureaucracy. How else could the government ensure that businesses were complying with its regulations? How else could it verify business costs so as to ensure that taxpayers were not being cheated? How else could it become truly aware of the legitimate range of alternatives open for discretionary decisionmaking? To make decisions for business in the manner

Lindblom envisions, government would have to duplicate much of what business does. This in fact is what the Defense Department's vast contracting bureaucracies do, and this is one of the reasons they have become so large. Bureaucracies of this size cost money--for salaries, equipment, office space, travel and so forth--and in this case money means taxes.

In addition, it would cost firms a certain amount of money to meet the reporting requirements the government would levy upon them in the process of exercising oversight and control. Defense firms face a plethora of such requirements, all designed to provide the government's parallel hierarchy with the information necessary to backstop the firm's decisions, report to the Congress, and so forth. They meet these requirements either by creating a separate organization within the firm to collect the information, or by allocating some part of each employee's working time to generating the information on his own. In either case this too costs money which probably would be passed on to consumers in the form of higher prices.

But the real costs of imposing Lindblom's scheme will arise in the process of getting business to submit to it in the first place. Recall the earlier point about why defense firms accept the Defense Department's control: although they receive assured profits, many firms have very little choice. This is not true for firms producing for "ordinary markets." In this case the government will have to buy the same kind of leverage over business that the Defense Department achieves by being, in some cases, a monopoly buyer.

Just how much this leverage will cost, of course, is difficult to estimate. Two arguments suggest that it may cost a great deal, however. First, existing analogies to what Lindblom has in mind do not inspire optimism that management will see any reason to hand over its autonomy cheaply. In the early experimental years of nuclear power plants, for example, the Atomic Energy Commission offered key firms assured profits to construct experimental plants despite the evident inefficiencies of producing power by this means. Although a few firms took the offer, they did so with limited enthusiasm. Had the government thrown extensive oversight and control into the deal

(which it did not), it seems likely that these firms would have dropped the idea altogether; there was plenty of money to be made elsewhere.³

Another analogy may be found at the edges of the defense sector, among firms that produce for the Pentagon but have reasonable markets in the civilian sector. In recent years concern has been rising that these "lower tier" defense industries may be disappearing because, among other things, the Defense Department's arcane managerial practices and paperwork demands have driven firms out of the market. Meanwhile small firms wishing to enter the defense contracting business simply cannot meet the high entry costs that derive from these same government demands.⁴ Thus, firms having other options take them, and buying their compliance with government control will surely involve more than just assuring them profits.

Professor Lindblom himself supplies a second reason for expecting businessmen to extract a high ransom in return for their compliance with the controls he has in mind. Corporate managers, he argues (pp. 350-351), do not pursue profits for personal remuneration. Rather, "corporate profit making is a kind of game, habit, or custom" (p. 350). Corporate managers, in short, want to be "privileged to play the game" (p. 351). But corporate autonomy is the privilege which allows the game to be played. Put another way, if federal bureaucracies are in control of business decisionmaking, then bureaucrats, not businessmen, are

³ Robert Perry, et al., *Development and Commercialization of the Light Water Reactor, 1946-1976*, R-2180-NSF (The Rand Corporation, June 1977), p. 20ff.

⁴ One of the most often cited articles to make this point is Debbie C. Tennison's "The Foundry Industry--Achilles' Heel of Defense?" in *National Defense*, March-April 1976, pp. 366-369. See also Jacques S. Gansler, "Let's Change the Way the Pentagon Does Business," *Harvard Business Review*, May-June 1977, pp. 109-118. Work at Rand suggests that the nation is losing its lower tier industries primarily because the Defense Department's demand for their services has dropped off since the Vietnam war. Still, DoD business practices are recognized as having a role in alienating some of these firms. See Geneese G. Baumbusch and Alvin J. Harman, *Peacetime Adequacy of the Lower Tiers of the Defense Industrial Base*, R-2184/1-AF (The Rand Corporation, November 1977), *supra*, but especially section V. For an argument that regulatory practices are driving small firms out of the civilian sector of the nation's economy, see "Where Overregulation Can Lead," *Nation's Business*, June 1975, pp. 26-32.

"playing the game." By Lindblom's own logic, paying businessmen to part with their autonomy may be expensive indeed.

It remains a separate and very important question whether yet another source of additional costs associated with Lindblom's scheme would arise from growing production inefficiencies in firms subjected to the kind of government control he has in mind. Critics of the defense sector virtually always cite its wastefulness and inefficiency, and by employing the defense sector to illustrate what he has in mind Lindblom opens his scheme to the same criticism. This is not a question on which the defense sector provides much data for an answer, however, for it is precisely on this issue that Lindblom's analogy breaks down; to the extent that it exists, inefficiency in the defense sector derives largely from that sector's character as a planner sovereignty system. It remains questionable whether Lindblom's consumer sovereignty system would suffer from the same problems. This is an important point, if only because Lindblom has chosen an imperfect analogy. Thus it deserves brief elaboration.

Most critics of the military establishment blame waste and inefficiency on the nature of the military's contract system and the lack of sufficient competition in the development and manufacture of weapon systems. In particular, the infamous "cost-plus" contract seems to encourage unrealistically low initial bidding on projects as well as sloppy production techniques because contractors know that the government will reimburse them even when their costs run considerably higher than expected. These are very real problems, ones the services try hard to prevent through thorough examination of submitted bids and, to a lesser extent, the use of competition in at least the earlier phases of system development.

In any case, critics often miss the point that what they see as inefficiency often stems less from the way the military contracts for what it buys than from the way it defines the products it wants. Although there is a great deal of variety in the way each military service manages the development and purchase of new weapons, in general they all put quality--in this case, technological sophistication--ahead of costs. Requirements for new weapons are often set against

or even beyond existing technical horizons, and firms that bid on these requirements often do so in legitimate ignorance of precisely what kinds of problems they will encounter in trying to meet them, and how much solving those problems will cost. Under these conditions cost-plus contracts are a virtual necessity; no firm will commit itself to a high risk venture without some assurance that the government will help cover unforeseen cost increases.

That there very often *are* unforeseen cost increases bears witness to the tendency of the nation's military services to demand that their requirements be met at any cost. Indeed, during the development of a new system a service often will spend a great deal of money to reach the goals set in its requirements, when a good deal less money would take it very close to those goals. And if a technical opportunity presents itself as a project evolves, the sponsoring service generally will pursue it to the limits of its budget. It is often these policies rather than waste and inefficiency in production that account for the sizable cost overruns and schedule slippages that often plague the weapons acquisition process. Not surprisingly, the services are better at meeting performance goals than staying within cost and schedule projections.⁵

Seen from this perspective, of course, cost overruns are not of themselves signs of inefficiency but rather the consequence of being unable to predict *a priori* what the development of sophisticated technology will cost. Still, meeting such requirements *does* force defense firms to employ what are by common standards of mass production highly labor intensive and apparently inefficient production techniques. In many cases they have no choice; the products they are asked to make are too sophisticated and make use of too exotic a set of materials to be produced any other way.⁶ Again, what passes for

⁵Robert Perry, et al., *System Acquisition Strategies*, R-733-PR/ARPA (The Rand Corporation, June 1971), pp. 1-10.

⁶Given the lack of competition in the production (if not the development) of most major weapons systems, of course, it might well be that even production of highly sophisticated systems could be done more efficiently than is often the case. This is why the use of competition in the development of new systems seems to produce lower prices in the long run, thereby compensating for the higher costs associated with duplicative developments in the project's early phases.

inefficiency stems from the requirements the government passes to industry.

Requirements define a product's output, and because efficiency is in the end a measure of cost per unit output, debates concerning efficiency in the defense sector ultimately come down to debates over the legitimacy of a given military requirement. These debates are unfortunately very subjective, because output in the defense sector is the very subjective notion of military effectiveness. Whether quality is really worth pursuing--as opposed to, say, large quantities of relatively simple weapons--is a matter of much importance. But it is a very subjective matter unless and until warfare itself provides the answers.

Clearly efficiency in the defense sector is a more complex topic than some critics make it out to be. Still, no matter how the issue is approached, the fact remains that efficiency there is intimately tied up with the fact that the military services both define and buy what defense firms produce. Because Lindblom's is a system in which controlled firms would continue to sell to consumers, his system might well escape the defense sector's peculiar problems in that area. In any case, no clear connection can be drawn between the problem of a consumer sovereignty as opposed to a planner sovereignty system.

The fact is, however, that no connection between the two need to be drawn to make the argument that Lindblom's system will not be a cheap one. The cost of buying compliance with controls, not to mention the costs of operating the controlling apparatus, may be steep enough to make the efficiency issue a minor one. To be sure, the defense sector can give us no precise notion of how expensive Lindblom's system might be. But it surely gives us cause for pessimism on this point.

* * *

Society may of course be willing to pay a relatively high price to curtail business autonomy. It may be especially willing to do so on the assurance that the bureaucracies of government that will control

business decisionmaking will be responsive to the democratic forces Lindblom mentions so often in his book. Again, however, experience in the defense sector provides no such assurance. Rather, it suggests that *even if* we are willing to pay the price, it is not control that we will be buying.

Consider, for example, the aforementioned tendency for each military service to push for quality at any price in the development of new weapons systems. Such an approach might appear to be the natural outcome of the conservatism common to all military services; cautious and likely to overstate the enemy threat, military officers can be expected to want the very best for their own troops. Yet neither the Soviets nor many European military forces share this approach.⁷ All seem more adept at and comfortable with making gradual product improvements in existing systems. The U.S. services learned their particular approach during the 1950s, when perceptions of the communist threat ran high, when Congress was fairly generous with funds (especially for the Air Force), and when the nation's technological inventiveness seemed its one strong suit in the Cold War.

Robert McNamara drove this approach home during his tenure in the Defense Department. Although McNamara worried about cost overruns, his attempts to control them through incentive-type contracting proved fruitless. Indeed, cost overruns continued to plague the acquisition process in large part because McNamara encouraged the services to exploit technology to the fullest. Scuttled projects like the MBT-70 tank and the Cheyenne helicopter, or marginally successful ones like the C-5 transport and the FB-111 fighter-bomber all bear somber witness to the enormous problems caused by pushing too fast past existing technical boundaries at the expense of budgets.

Largely in response to these problems, Deputy Secretary of Defense David Packard sought to alter these habits by introducing in the early 1970s a series of innovative practices in Defense Department purchasing. Not least among his new policies was that of "designing

⁷ See Arthur J. Alexander, "Weapons Acquisition in the Soviet Union, United States, and France," P-4989 (The Rand Corporation, March 1973).

to cost": project offices would impose (or have imposed on them) a strict cost goal at the start of a project, and thereafter *trade off* higher performance if necessary to hold costs to the mark. Some of the projects initiated under Packard's guidance stayed remarkably close to projected cost goals during their first phases. But now, as many of these systems near production, costs have in general begun to rise as the services alter requirements and decide, belatedly, to go for more performance at extra expense.

The fact is that the Defense Department's contracting organizations and the larger bureaucracies behind them are not very responsive; they tend to move ponderously in one direction, responding only partially if at all to the subtleties of policy directives. And we can find the same kind of behavior at other levels of the acquisition process. As Robert Coulam argues in his *Illusions of Choice* (Princeton University Press, 1977), setting requirements for new weapons tends to be a cybernetic process; the services simplify the complex problem of determining new needs by focusing on a few key performance parameters and asking for increased performance in these areas with each new generation of weapons. The process is surprisingly resistant to change; only disruption in the organization's environment (defeat in battle, for example) seems capable of alerting the service to the importance of other weapons capabilities.

The organizations necessary to implement Dr. Lindblom's system would, unfortunately, present the same kind of intractable organizational and managerial problems. The system might be constructed and at some expense be set in motion. But it is highly doubtful that, once ensconced, these organizations would be responsive to the kind of policy initiatives Lindblom has in mind. He is talking, after all, about a "meticulous task of designing a highly discriminating mixture of financial inducement to business with government control over them" (p. 349). Little in the Defense Department's experience suggests that meticulousness and discrimination are part of the organizational repertoire.

If experience in the defense sector points up a flaw in *Politics and Markets*, it is Dr. Lindblom's concentration on business privilege and the business veto at the expense of the enormous organizational problems now posed by the federal government. While he lays a long list of social ills at the doorstep of the business veto, he argues that governments can take on "meticulous" tasks. But the search for solutions to collective problems has spawned a growing federal bureaucracy. And to the extent that these organizations present elected officials with the same tough managerial problems posed by the Defense Department's contracting agencies, they in a very real sense pose their own veto to thoughtful and creative policy. Ironically, were we to implement the system Dr. Lindblom has in mind, this bureaucratic veto would become the most ubiquitous and damaging of all.

